

EXECUTIVE SECRETARIAT

Routing Slip

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OGI
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Executive Secretary

9/2/83
Date

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CABINET AFFAIRS STAFFING MEMORANDUM

Executive Registry
83-4340

Date: September 1, 1983 Number: 118852CA Due By: _____
Subject: Cabinet Council on Economic Affairs, September 6, 1983

	Action	FYI		Action	FYI
ALL CABINET MEMBERS	<input type="checkbox"/>	<input type="checkbox"/>	CEA	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Vice President	<input checked="" type="checkbox"/>	<input type="checkbox"/>	CEQ	<input type="checkbox"/>	<input type="checkbox"/>
State	<input checked="" type="checkbox"/>	<input type="checkbox"/>	OSTP	<input type="checkbox"/>	<input type="checkbox"/>
Treasury	<input checked="" type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
Defense	<input checked="" type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
Attorney General	<input type="checkbox"/>	<input checked="" type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
Interior	<input type="checkbox"/>	<input checked="" type="checkbox"/>			
Agriculture	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Baker	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Commerce	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Deaver	<input type="checkbox"/>	<input type="checkbox"/>
Labor	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Clark	<input type="checkbox"/>	<input checked="" type="checkbox"/>
HHS	<input type="checkbox"/>	<input checked="" type="checkbox"/>	Darman (<i>For WH Staffing</i>)	<input checked="" type="checkbox"/>	<input type="checkbox"/>
HUD	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Harper	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Transportation	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Jenkins	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Energy	<input type="checkbox"/>	<input checked="" type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
Education	<input type="checkbox"/>	<input checked="" type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
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OMB	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
CIA	<input type="checkbox"/>	<input checked="" type="checkbox"/>			
UN	<input type="checkbox"/>	<input checked="" type="checkbox"/>			
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EPA	<input type="checkbox"/>	<input type="checkbox"/>	CCFA/	<input type="checkbox"/>	<input type="checkbox"/>
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SBA	<input type="checkbox"/>	<input type="checkbox"/>	CCMA/Bledsoe	<input type="checkbox"/>	<input type="checkbox"/>
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REMARKS: The Cabinet Council on Economic Affairs will meet on Tuesday, September 6, 1983 at 8:45 A.M. in the Roosevelt Room. The agenda and Background papers are attached.



RETURN TO:

☐ Craig L. Fuller
Assistant to the President
for Cabinet Affairs

☐ Katherine Anderson
☒ Tom Gibson

☐ Don Clarey
☐ Larry Herbolsheimer

Associate Director

Office of Cabinet Affairs

THE WHITE HOUSE

WASHINGTON

September 1, 1983

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: ROGER B. PORTER *RBP*

SUBJECT: Agenda and Papers for the September 6 Meeting

The agenda and papers for the September 6 meeting of the Cabinet Council on Economic Affairs are attached. The meeting is scheduled for 8:45 a.m. in the Roosevelt Room.

The first agenda item is a report from the Working Group on Unemployment and Unemployment Compensation. The central issue for discussion is the position the Administration will take on extending the Federal Supplemental Compensation (FSC) Program which expires on September 30, 1983. A paper, prepared by the Working Group, describing the way in which the program has worked and the ways it relates to the regular and extended benefit programs, and outlining options regarding whether to support an extension of the program, and if so, what if any modifications in the current program the Administration should seek, is attached.

The second agenda item concerns worldwide unitary taxation. Several weeks ago the Council established a Working Group on Unitary Taxation to identify the federal and state interests in the worldwide unitary method of taxation and to develop possible legislative options. A paper from Assistant Secretary of the Treasury John Chapoton, chairman of the Working Group, is also attached.

Attachments

THE WHITE HOUSE
WASHINGTON

CABINET COUNCIL ON ECONOMIC AFFAIRS

September 6, 1983

8:45 a.m.

Roosevelt Room

AGENDA

1. Report of the Working Group on Unemployment and Unemployment Compensation (CM#190)
2. Unitary Taxation (CM#214)



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503
September 1, 1983

MEMORANDUM FOR THE MEMBERS OF THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: THE WORKING GROUP ON UNEMPLOYMENT AND UNEMPLOYMENT COMPENSATION

SUBJECT: EXTENSION OF THE FEDERAL SUPPLEMENTAL COMPENSATION (FSC) PROGRAM

ISSUE

The FSC program is a temporary program which provides additional weeks of unemployment benefits to individuals who have exhausted their entitlement to regular and/or extended unemployment benefits. The program expires on September 30, 1983. Immediately following the August recess, Congress will begin deliberations on whether to extend the program beyond the current expiration date. Hearings have been scheduled in the House on September 13 and in the Senate on September 16. The Administration must develop a position on an extension promptly. Two major issues require decisions:

- o Whether to support an extension of the program, and if so,
- o What should be the duration of the extension and,
- o What, if any, modifications in the current program should the Administration seek (e.g. the duration of benefits and various provisions to tighten eligibility requirements).

If the Administration decides to support an extension, then a related issue requires a decision: Whether to press for previously adopted Administration employment proposals, such as the job vouchers for the long-term unemployed and the youth differential minimum wage for summertime employment, along with the FSC extension. Last March, these initiatives were proposed along with an Administration supported FSC extension, but received little active support in either the House or the Senate.

BACKGROUND

A. THE REGULAR AND EXTENDED BENEFIT UNEMPLOYMENT INSURANCE PROGRAMS

The permanent unemployment insurance (UI) program consists of two separate programs: the regular UI program and the extended benefits program. Under the regular UI program, states are free to set benefit levels and the duration of benefits. Although there is considerable variation across states, the average weekly benefit paid in 1982 was \$113. Most states pay benefits for a maximum of 26 weeks. Benefits are financed by the states through the imposition of payroll taxes levied on employers.

The Extended Benefit program provides up to 13 additional weeks of unemployment benefits to individuals in high unemployment states who have exhausted their entitlement to regular benefits.

Extended benefits are payable in any state in which the insured unemployment rate either

- o Exceeds 5 percent and is 20 percent above the average rate for the same period of the prior 2 years, or
- o Exceeds 6 percent regardless of the previous rate.

Extended benefits are financed jointly by the Federal and individual state governments on a 50-50 basis. The Federal share is financed by a Federal payroll tax levied on employers.

The regular and extended benefit programs are quite comprehensive in scope and coverage. According to the most recent Labor Department data and estimates, the regular UI program will provide \$21.7 billion in benefit payments to an estimated 10.6 million unemployed individuals during FY83. The extended benefit program will provide an additional \$2.3 billion during fiscal year 1983 in benefit payments to 2 million unemployed individuals who exhausted regular benefits.

B. THE FEDERAL SUPPLEMENTAL COMPENSATION (FSC) PROGRAM

The FSC program was enacted in August 1982 in response to the high unemployment levels of the recession. At that time, the unemployment rate stood at 9.8 percent of the labor force and was expected to increase during succeeding months. The program was originally designed as a temporary measure and was set to expire on March 31, 1983. As enacted, the FSC program provided Federal general revenue financed additional weeks of unemployment compensation to individuals who exhausted regular and, where payable, extended benefits. The number of weeks of additional benefits payable under the original program ranged from 6 to 10 weeks depending upon the state's insured unemployment rate.

Subsequently, the FSC program has been modified on several occasions and extended once. In December 1982, the number of weeks of benefits payable was increased to a minimum of 8 and a maximum of 16 as part of the Surface Transportation Act. In March, the program was extended for an additional six months and benefit durations were further modified to range from 8 to 14 weeks depending on the state's insured unemployment rate. The March legislation also provided for 10 additional weeks of benefits for individuals who previously exhausted FSC benefits prior to March 31. This increased the maximum number of weeks of unemployment benefits payable to certain individuals under all three UI programs to 65. In August, the program was again altered. The most recent change was to limit the reduction in weeks of benefits payable in states with declining insured unemployment rates.

As a result, the present FSC program is an administrative nightmare. States may pay one of four tiers of FSC benefits, ranging from 8 to 14 weeks. Which tier of benefits is payable in a given state is determined by the following factors:

- The state's insured unemployment rate for the most recent 13 weeks.
- The number of weeks of FSC that were payable in the state for the week of July 24 compared to the number of weeks payable for the week of March 27.

An estimated 27 states will pay a different number of weeks of FSC in September to individual claimants, depending on whether the claimant filed an initial FSC claim before or after June 5, 1983. In the case of a claimant who files for benefits in a different state from the one in which he was employed, the complexity of benefit determinations increases severalfold.

The current FSC program and the spasmodic changes which have led to its complexity are symptomatic of the political difficulty of addressing the Nation's high unemployment rate in a rational manner. Each legislative change was enacted just prior to a Congressional recess. Each legislative change was enacted in a feverish rush to complete Congressional action before members returned home to constituents. Each legislative change was enacted to ensure that no member of Congress had to return home to his or her district or state having voted for a significant reduction in benefits for his or her constituents.

The result is a costly program that defies any conception of programmatic rationality. As originally enacted, the 6-month FSC program was estimated to cost \$2.1 billion. The subsequent extension and modifications have resulted in a program that will cost \$5.6 billion during FY83. The fact that all of the legislative changes occurred in a non-election year must give cause for concern as we approach 1984.

CURRENT CONGRESSIONAL SENTIMENT

A. GENERAL CONSIDERATIONS

Legislative spending initiatives are sticky on the downward side. Despite the fact that the unemployment rate at 9.5 percent of the labor force is lower than it was when Congress enacted the FSC program, there is strong sentiment on both sides of the aisle in both Houses of Congress to extend the life of the program. Little consideration has, as yet, been given to the particulars and duration of any extension other than simplifying the program. It is, however, unclear what will happen when this desire for simplification runs headlong into the cold hard fact that any simplification is likely to result in some member's district or state receiving fewer benefits than provided under the current program.

Moreover, the lesson of the past year should clearly indicate that no matter how simplified any extension is at the outset, it will likely turn into an administrative monster as unemployment continues its downward pace at differential rates across states.

Also, it should be recognized that any short-term extension is likely to be further extended during FY84. A six-month extension would terminate in March 1984 as the campaign moves into full-swing. A one-year extension would terminate a scant five weeks before the election. And a 15-month extension would terminate while Congress is out of session. Pressure to continue the program for 18 months will be strong.

B. THE EXTENDED BENEFIT THREAT

The Omnibus Reconciliation Act (OBRA) of 1981 made several important changes in the Extended Benefit program. These changes included:

- o Eliminating the national trigger,
- o Modifying the calculation of the insured unemployment rate, and
- o Raising the insured unemployment rate thresholds necessary to trigger the extended benefit program on in a state.

These reforms have resulted in profound budgetary savings during 1982-83 -- approximately \$3 billion. If the reforms remain intact during the next three years, they will produce an estimated additional \$6 billion in savings relative to pre-OBRA law.

Currently, the Extended Benefit program is in effect in only three jurisdictions: Puerto Rico, West Virginia, and Louisiana. Louisiana is expected to trigger off in the next few weeks. The combination of high unemployment and the fact that Extended Benefits are payable in so few jurisdictions has produced a severe Congressional threat to the reforms. Several bills have been introduced to repeal the OBRA changes and pressure can be expected to build considerably when Congress returns on September 12.

The FSC program has, in the past, proven to be an effective safety valve to relieve pressure to repeal the OBRA reforms of the Extended Benefit program. Administration support of an extension of FSC may also prove effective for this purpose in the current climate.

Given the Congressional threat to the Extended Benefit program reforms, the cost of extending the FSC program should be considered along with the costs of Congressional repeal of these reforms. The following table, therefore, considers the costs of a 6 and 18 month extensions of FSC along with the cost of repealing the Extended Benefit reforms. Three alternative extensions are considered:

- o A program which would provide 8 additional weeks of benefits in all states,
- o A program which would provide 6 weeks of additional benefits in low unemployment states, 8 weeks of additional benefits in medium unemployment states, and 10 weeks of additional benefits in higher unemployment states, and
- o A program similar to the above but with 8, 10, and 12 weeks for low, medium and higher unemployment states respectively.

IMPACT ON FEDERAL DEFICIT
(\$ in millions)

	<u>FY84</u>	<u>FY85</u>	<u>FY86</u>	<u>TOTAL</u>
REPEAL OF OBRA REFORMS.....	4060	1550	650	6260

<u>ALTERNATIVE FSC PROGRAMS</u>	<u>6-MONTH</u>	<u>18-MONTH</u>
EXTEND CURRENT 8-10-12-14 PROGRAM 6 MONTHS.....	1290	4020
8 WEEK PROGRAM.....	1000	3310
6-8-10 WEEK PROGRAM.....	1050	3310
8-10-12 WEEK PROGRAM.....	1200*	3783*

* Preliminary Estimate

OPTIONS

A. ISSUE 1: EXTENDING THE PROGRAM

Option 1: Oppose an extension of the FSC Program.

Advantages: FSC is not necessary in a period of declining unemployment. It deters some people from returning to work, thereby slowing the decline in unemployment. It is costly and untargeted; it provides benefits financed by the general taxpayer to people without regard to their other income or resources.

Disadvantages: Congressional sentiment to extend FSC is strong. Given the Congressional mood, Administration opposition to an extension is not likely to be effective.

Option 2: Support an extension of the FSC program; oppose all attempts to repeal extended benefit reforms; and support Administration employment-related proposals.

Advantages: Extension of temporary FSC program is a small price to pay programmatically and budgetarily to preserve the Extended Benefit reforms.

Disadvantages: FSC extension may be insufficient to ward off growing Congressional pressure to roll back the Extended Benefit reforms.

B. ISSUE 2: THE DURATION OF THE EXTENSION

Option 1: Support a six-month extension of the program.

Advantages: If the unemployment rate declines faster than expected, this option leaves open the possibility of allowing the program to expire or reducing benefit durations in a subsequent extension.

Disadvantages: Would enable justifying an overly generous program on the grounds that it falls within budget resolution guidelines.

Option 2: Support an 18-month extension of the program.

Advantages: Requires Congress to address the cost of an extension on a realistic basis thereby reducing the likelihood of an overly generous program.

Disadvantages: Would result in a program supposedly enacted as a temporary measure to deal with a recession being extended two years beyond the end of the recession. Such a program would be difficult to terminate.

C. ISSUE 3: MODIFICATIONS OF CURRENT FSC PROGRAM

Option 1: Recommend a simple 8 week program for eligible recipients in all states.

Advantages: Simple to understand and administer. Same benefits to all States.

Disadvantages: Likely not as effective in forestalling Extended Benefit changes as a tiered program.

Option 2: Recommend a three-tiered 6-8-10 week program that would provide more weeks of benefits for individuals in higher unemployment states.

Advantages: Appropriate at this point in cycle, with unemployment lower than the 9.8% level that existed when FSC was originally enacted as a 6-8-10 week program.

Disadvantages: Would reduce number of weeks payable in all States from level currently payable. (Most States would decline by 2 weeks. Maximum decline: 4 weeks.)

Option 3: Recommend a three-tiered 8-10-12 week program that would provide more weeks of benefits for individuals in higher unemployment states.

Advantages: Closer in number of weeks to current 8-10-12-14 program. Most states would maintain current number of weeks of FSC.

Disadvantages: Fails to adjust FSC downward to reflect decline in national unemployment, even though program was previously adjusted upward in response to an increase in unemployment. More costly than the 6-8-10 week program.



DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

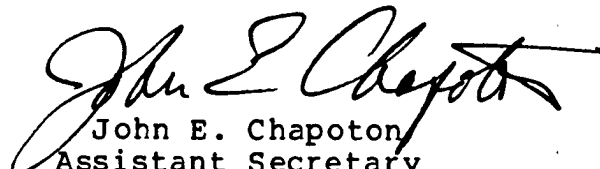
September 1, 1983

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

Subject: Worldwide Unitary Taxation

Attached is an Options Paper prepared by the Working Group on Unitary Taxation. The paper was prepared at the request of the CCEA to identify the federal and state interests in the worldwide unitary method of taxation and to develop possible legislative options. The paper sets forth four options and discusses the advantages and disadvantages of each. Appendix A outlines and briefly discusses alternative procedures to implement these options. Appendix B considers the associated issue of state taxation of foreign dividends. I have also attached an executive summary of the Options Paper and Appendix A.

No recommendation is made in the Options Paper since the Working Group did not reach a consensus. The discussion of options includes arguments made by members of the Working Group in favor of and against each of the four alternatives.


John E. Chapoton
Assistant Secretary
(Tax Policy)

Attachments

September 1, 1983

EXECUTIVE SUMMARY

Options Paper

Prepared by the Working Group on Unitary Taxation
for the Cabinet Council on Economic Affairs

The Cabinet Council on Economic Affairs established a Working Group on Unitary Taxation to identify the federal and state interests in the worldwide unitary method of taxation and to develop possible legislative options. This paper sets forth four options. Appendix A outlines procedures to implement these options. Appendix B considers the associated issue of state taxation of foreign dividends. No recommendation is made since the interagency working group did not reach a consensus. However, the discussion of the options includes arguments made by members of the working group in favor of and against each of the four alternatives.

Background

The worldwide unitary method of taxation has been adopted by about 13 states to determine the income of a business taxable by a state when the business is carried on by related corporations that operate both within the state and abroad. Under this approach, income from each corporation, domestic or foreign, that is part of a unitary business is combined to determine the income of the corporate group. The amount of this combined income attributable to the business in the taxing state is calculated by a formula that usually includes three factors, the share of payroll, property and sales within the state relative to the totals for the group.

The alternative to the worldwide unitary method of taxation is for states to tax multinational corporations on a separate accounting basis, by allocating income among related corporations according to "arm's-length" prices, so that the flow of goods and services between an in-state corporation and a related corporation located abroad is valued at prices that would prevail if the two businesses were unrelated. The separate accounting method does not take into consideration the income of affiliated corporations not doing business within the taxing jurisdiction.

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The separate accounting method is currently employed by most states with corporate income taxes, even though many states use a unitary apportionment formula for determining the allocation of income earned by a single corporation that operates in more than one taxing jurisdiction. This method also is used by the federal government, and by virtually all foreign governments with which the United States has an active trade or investment relationship.

Issue

Foreign governments, in support of their business and investment communities, and domestic multinational corporations are seriously concerned that the worldwide unitary method of taxation leads to the taxation of foreign source income by the states. These concerned parties point out that the federal government not only employs the separate accounting system with respect to federal taxation of multinational corporations but also, through tax treaty negotiations, has urged other countries to adopt "arm's length" pricing as the standard method to avoid double taxation.

The states argue that the system of separate accounting permits multinational businesses to shift profits away from their taxing jurisdictions artificially, thereby creating a drain on needed state revenues. They further point out that the more complicated system of separate accounting is unworkable for them because there are no objective standards for determining "arm's-length" prices and because the administration of such a system is frequently too costly. Last, the states support their right to be free from federal interference in establishing their fiscal policies.

There is great merit to uniformity among taxing jurisdictions, because double taxation will be avoided. Most who have carefully studied the issue agree, however, that neither the separate accounting method nor the worldwide unitary method is inherently incorrect.

Since 1965, legislation has been introduced almost annually to force states to conform to federal tax practices, however, it has never been approved by Congress. Representative Conable and Senator Mathias have again sponsored such legislation in the 98th Congress. Last June, the Supreme Court upheld California's right to use the worldwide unitary method of taxation as applied to U.S.-based multinationals in the Container Corporation case.

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California's success before the courts has encouraged at least one state (Florida) to adopt the worldwide unitary method, and it is likely that other states may soon follow. In the wake of the Container Corporation decision, governments of virtually all of the major trading nations have expressed strong objections to the unitary tax method and to the lack of federal intervention. There are indications that several foreign governments are contemplating retaliatory tax measures against U.S. multinational corporations. Furthermore, we understand that developing countries may be considering adopting the worldwide unitary method for U.S. and other foreign investors.

Options

Option One: Retain present state unitary taxation practices. No federal restrictions would be placed on state application of the worldwide unitary method.

- Advantages:
- o Respects state sovereignty
 - o Reflects historical congressional reluctance to act
 - o Protects present levels of state revenues
 - o Is an easy method for states to administer
 - o Foreign impact is currently uncertain
- Disadvantages:
- o Ignores objections from foreign governments
 - o Adversely affects negotiation of tax treaties
 - o May lead to double taxation
 - o May cause trade and investment distortions
 - o Imposes heavy paperwork burden on taxpayers
 - o Causes exposure to foreign retaliation or use of method
- Implementation: Do nothing, i.e., no support for legislative or judicial initiatives to restrict states.

Option Two: Prohibit worldwide combination. Worldwide combination would be prohibited both for U.S. and foreign-based multinationals.

Advantages and Disadvantages: The reverse of those listed for Option One.

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Implementation: Support restrictions on the worldwide unitary method by (1) filing a submission before the Supreme Court in the Container Case; and/or (2) support Mathias-Conable or a separate Administration legislative initiative.

Option Three: Prohibit unitary combination of foreign controlled groups. Worldwide unitary combination would be disallowed only for foreign-controlled corporate groups. The worldwide unitary method would still be permitted for U.S.-controlled groups.

Advantages:

- o Responds to objections of foreign governments
- o Creates tax treaty "bargaining chip"
- o Limits state revenue losses

Disadvantages:

- o Discriminates against U.S. multinationals
- o States may oppose on sovereignty grounds
- o Creates tax treaty ratification difficulties

Implementation: Seek judicial remedy in an appropriate case, and/or support legislation; include a restriction on the unitary method in bilateral income tax treaties.

Option Four: Federal minimum standards for application of worldwide combined unitary method. The worldwide unitary method would be allowed, but the federal government would develop, in consultation with the states, minimum standards designed to ensure that the application of the method does not disrupt international relations or the international economic interests of the United States. Federal intervention would be limited since the federal standards would be limitations and would not require exact state conformity to a federal model.

Advantages:

- o May be viewed as a compromise between competing interests
- o Avoids possible overreaction to problem

Disadvantages:

- o Will not satisfy interested parties
- o Delays final resolution as standards are developed

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Implementation: Decline to participate in the Container
Case or to support Mathias-Conable; develop
federal minimum standards (could take
considerable time and may or may not
require eventual federal legislation).